



Monthly Economic Monitor Ukraine

- The President and the Prime Minister agreed to hold early parliamentary elections.
- In the first quarter the real GDP increased by 8.0% yoy.
- The State Property Fund law was passed by Verkhovna Rada.
- Ukraine's membership in the WTO is likely to be postponed until 2008.
- Central fiscal surplus reached 1.4% of the GDP due to high tax revenues and considerable under-execution of expenditures.
- Between January and March real wages grew by 14.8% yoy.
- Inflation accelerated to 10.5% yoy in April.

No.5 (79)
May
2007

Politics: Compromise was reached over early parliamentary elections

Political crisis continued to develop in April. On April 17, the Constitutional Court of Ukraine began consideration of constitutionality of the Presidential Act on dissolution of the Parliament. A day earlier, the Security Service of Ukraine partially confirmed accusations of receiving USD 12 m bribe by Syuzanna Stanik, a Deputy Head of the Constitutional Court. Mrs. Stanik as well as Prosecutor-General's Office denied these charges. On April 26 the President issued another Decree on dissolution of the Parliament that rescheduled the early parliamentary elections for June 24 from May 27. The President reiterated the reasons for the dissolution: neglect of people's will, violation of constitutional right to vote and the principle of people's sovereignty. As it was the case with the first Decree, the Coalition refused to comply, and filed the claim to the Constitutional Court.

On April 26 the President reinstated Svyatoslav Piskun as Prosecutor-General according to the court decision. The validity of the reinstatement is dubious, as the Ukrainian law does not allow the President to unilaterally appoint the Prosecutor General.

On May 4 the President announced an agreement with Prime Minister Viktor Yanukovich on holding early parliamentary elections. The Working Party was established to prepare necessary documents to unblock the electoral process. The further changes in Ukraine's political architecture are expected to accompany the new elections.

Real Economy: Real GDP increased by 8.0% yoy

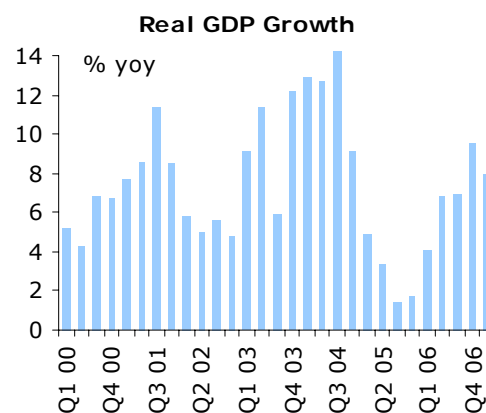
According to the Derzhkomstat, in the first quarter of 2007 the real GDP grew by 8.0% yoy as compared to a 4.1% yoy increase during same period in 2006. Both strong domestic private demand and recovery of exports contributed to the GDP growth on demand side. On supply side, manufacturing, construction and trade retained the highest rates of growth at about 14%. At the same time, value added in electricity, gas and water supply continued to decline by 4.1% yoy. A stable decline in this sector in the early spring suggests that a mild winter accounts for a relatively small portion of it, while a more likely reason is higher gas, electricity, utility prices and thus a lower demand.

In the first quarter industrial output increased by 12.5% yoy compared to 0.6% yoy growth a year before. The largest contributors to growth were machine building and metal production. The former increased by 23.9% yoy due to increased transport equipment production, stimulated by external and domestic private demand for cars. Despite a small deceleration in metal production, likely due to problems with raw material supply, the sector alone accounts for almost one third of overall industrial growth.

Sectoral trends: State Property Fund Law was passed

Privatization. In April the Verkhovna Rada approved the Law about State Property Fund of Ukraine (SPFU) that defines its major functions as an executive body, its status and structure. According to

Population: 46.7 m
Industry/GDP: 26%
Agriculture/GDP: 8%
Investment/GDP: 24%
Exports to: Russia 23%, EU 28%
Imports from: Russia 31%, EU 35%



Source: Derzhkomstat

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the law, the SPFU is accountable to the Parliament, while the Cabinet of Ministers coordinates its activity. It is unclear whether the law would improve management practices of the Fund as this law is devoted mainly to defining the SPFU authority. Taking into account the questionable legal status of the Parliament, this Law is unlikely to be signed by the President.

The Cabinet of Ministers approved the list of enterprises subject to privatisation in 2007. The list contains 634 enterprises, out of which 73 are completely owned by the state. Though to reach the privatisation receipts target at UAH 10.5 bn, the SPFU should rely on few large sales like privatisation of telecommunication giant Ukrtelecom and chemical factory Odessa Portside Plant. Meanwhile, the trials on previously privatised enterprises continue. In particular, court refused to freeze controlling stake in the Nikopol Ferroalloy Plant to prevent dilution of the share of the plant returned to state by the Supreme Court in March.

Transportation. In April 2007 the Parliament adopted the first reading of a draft law on concessions that aims at improvement of construction, operation and repair of roads. An important feature of the draft is that it strengthens investment guarantees that would allow attracting more funds to build and operate Ukrainian roads. Though, the efficiency of the law could be undermined by its drawbacks, for instance a vaguely defined government participation in the "concession project".

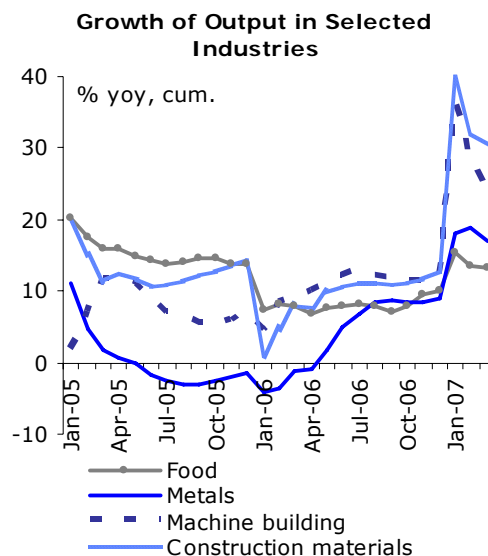
In the spring of 2007 prices for international passenger tickets have increased by 10-23% depending on the services. The increase was justified by non-profitability of the passenger carriage and a need to cover the costs. Cost-covering pricing would allow investing in equipment and reduce cross-subsidies. However, the major problem - the determination of this adequate price in the case of monopoly - remained unresolved.

Energy. In April 2007 the first coal auctions for state mines took place, though the necessary legislation was passed in 2000. Their main purpose was to define market price for coal. Only 6 lots equal to 8% of the amount offered, were sold. The low demand could be explained both by seasonal factors and the fact that only small companies participated in the auction, while major buyers used other schemes like direct contracts or wholesale market purchases. Nevertheless, coal auctions are the important step in reforming the industry as it makes coal sales more transparent and provides an alternative, less bureaucratic way to buy coal.

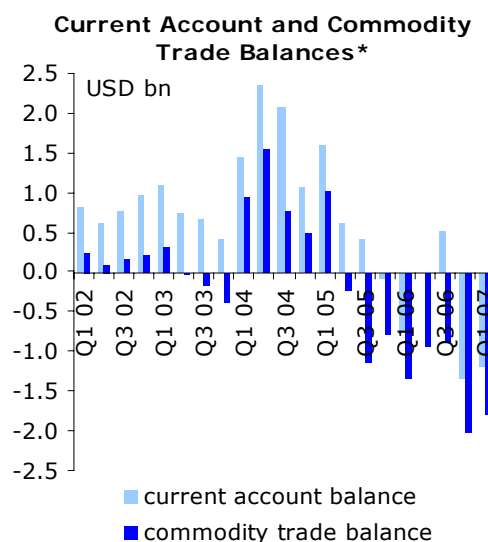
External sector: WTO membership is delayed again

Ukraine's membership in the WTO is likely to be postponed until 2008. According to the Ministry of Economy, Ukraine has to pass eight or nine laws to complete the harmonization of the legislation with the WTO rules and requirements. This list of laws was established after the Working Party studied the laws passed in November-December 2006. Also, Ukraine has to finalize the bilateral talks with Kyrgyzstan, and reach agreement on the aggregate support measures in agriculture.

According to the preliminary estimate of the NBU, in the first quarter the balance of the current account remained negative at USD 1.2 bn (4.6% of GDP). As in the past, the major reason for current account deficit was the deficit of commodity trade that reached USD 1.8 bn during this period. The growth of commodity exports (32.0% yoy) continued lagging behind the growth of imports (32.4% yoy). Metal production, chemical industry and machine building contributed the most to the growth in exports. Mineral products accounted for a large share of the imports growth, mostly due to an increase in gas prices. Also, accelerated investment activity and private demand for durables drove up the imports of machinery and equipment. The current account deficit was fully financed by the continued long-term capital inflow. Foreign direct investment (FDI) inflow was USD 1.0 bn, close to the amount in the last quarter of 2006. Also, long- and medium-term bond sales attracted USD 2.8 bn.

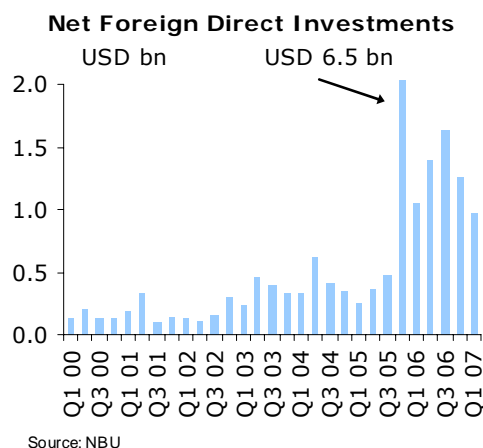


Source: Derzhkomstat



Source: NBU

* Preliminary estimate by the NBU for Q1 2007



Fiscal policy: Central fiscal surplus reached 1.4% of GDP due to under-execution of expenditures

In the first quarter of 2007 the central fiscal revenues were executed at 106.0% of the target due to high tax revenues. In particular, the VAT and enterprise profit tax revenues were over-executed by 4.0% and 19.7%, respectively, thanks to fast economic growth. At the same time, the execution rate of the central fiscal expenditures remained low and reached only 87.9% of the plan. Traditionally, social protection expenditures and transfers to local budgets had the highest execution rate at above 95% of the target, while health care and housing expenditures were substantially under-executed at 58.3% and 41.9% of the target, respectively. The resulting central fiscal surplus reached UAH 1.9 bn or 1.4% of GDP.

Social policy: Real wages grew by 14.8%

Between January and March real wages grew by 14.8% yoy, slowing down as compared to the same period of the last year (23.8% yoy). The average wage in March reached UAH 1230. The lowest wage growth was in education and healthcare, while during the first three months of 2006 the wage growth in these sectors was among the highest. The wages also grew slower in the state administration sector. Such trends are likely due to the government policy of limiting wage increases in publicly funded sectors. We can expect that real wages in these sectors would increase faster by the end of the year due to higher than previously planned increases in minimum wages. At the same time, the real wage growth in industry was at 14.0% yoy, which is similar to the last year's figures. This situation is caused by further redistribution of funds from wage payments to other needs stimulated among others by increased energy costs.

Monetary policy: Inflation increased to 10.5% yoy

Inflation rate accelerated slightly and reached 10.5% yoy in April as food prices continued to grow, while the utility price increases receded and some industrial goods prices declined. Political crisis did not impact inflation significantly. However, the future price growth could be affected by election campaign as government may try to limit growth of so-called social goods prices and increase payments to low-income groups of population.

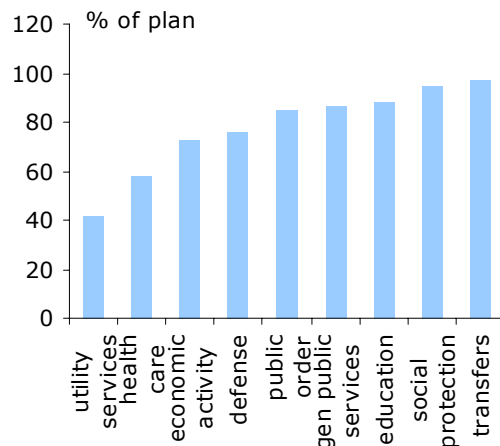
The monetary base grew by 27.7% yoy and the money supply grew by 40.5% yoy in April, as the NBU purchases of foreign currency market were considerable, and government funds at the NBU decreased slightly. In contrast to the previous three months in April the NBU did not sell deposit certificates to commercial banks, despite the substantial free liquidity, which may signify commercial bank's desire to keep additional liquidity due to political situation.

Financial markets: The procedures governing the formation of bank's loan loss reserves were changed

Banking sector The amended rules governing the formation of bank's loan loss reserves became effective on April 10. According to the amended rules commercial banks can now assess credit risks for portfolios of similar consumer loans instead of classifying them individually. Higher reserve requirements were introduced for credits in foreign currency to borrowers with and without foreign currency income and for consumer loans. For some credit types reserve requirements were increased by more than 1.5 times. These changes will streamline servicing of consumer credits by banks and contribute to the stability of the banking system. On the other hand, introduced changes would make credits in foreign currency more expensive for banks, creating the disincentives for dollarization. However, increased loan-loss provision charges may also limit recapitalization of banks because their profits will decrease.

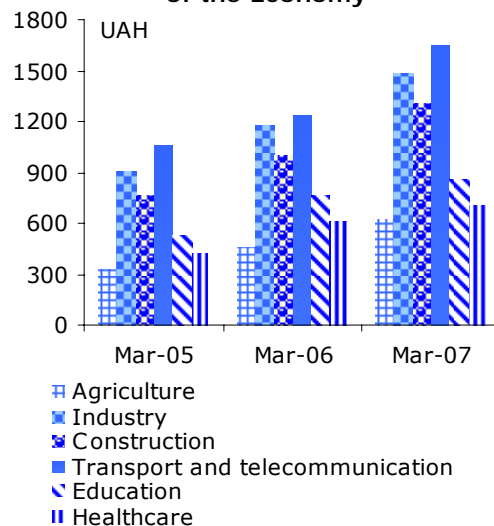
Exchange rate. In April hryvnia slightly appreciated relative to the US dollar. On April 27 UAH/USD inter-bank exchange rate at close was 5.009 compared to 5.032 on March 30 close. Thus, political crisis didn't bring depreciation that is usual during such events.

Central Fiscal Expenditures in the first quarter 2007



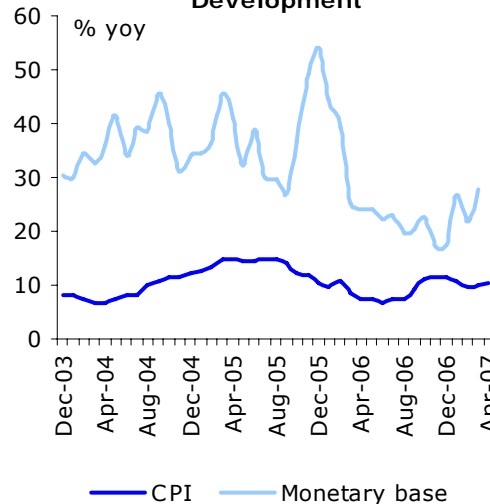
Source: State Treasury

Average Wage in the Key Sectors of the Economy



Source: Derzhcomstat

CPI and Monetary Base Development



Source: Derzhcomstat, NBU



| Economic Trends | | Q4 05 | Q1 06 | Q2 06 | Q3 06 | Q4 06 | Dec | Jan | Feb | Mar | Apr |
|--------------------------------|-------------|-------|-------|-------|-------|-------|--------|--------|--------|------|------|
| GDP growth (real) | % yoy | 1.7 | 4.1 | 6.8 | 6.9 | 9.5 | ... | 9.3 | 7.9 | 7.0 | ... |
| GDP growth (real) | % yoy cum. | 2.6 | 4.1 | 5.5 | 6.1 | 7.1 | 7.0* | 9.3 | 8.6 | 8.0 | ... |
| Industrial production (real) | % yoy cum. | 3.1 | 0.2 | 3.6 | 5.5 | 6.2 | 6.2 | 15.8 | 13.4 | 12.5 | ... |
| Agricultural production (real) | % yoy cum. | 0.0 | 4.0 | 3.2 | -2.8 | 0.4 | 0.4 | 6.9 | 5.6 | 5.0 | ... |
| CPI | % yoy eop | 10.3 | 8.6 | 6.8 | 9.1 | 11.6 | 11.6 | 10.9 | 9.5 | 10.1 | 10.5 |
| PPI | % yoy eop | 9.6 | 6.5 | 6.3 | 10.7 | 14.4 | 14.4 | 15.6 | 16.5 | 17.9 | 18.7 |
| Exports (USD)*** | % yoy cum. | 7.5 | -0.3 | 4.7 | 10.7 | 13.2 | 12.1" | 37.2" | 34.5" | ... | ... |
| Imports (USD)*** | % yoy cum. | 20.4 | 24.9 | 19.7 | 19.8 | 22.0 | 24.6" | 36.5" | 35.7" | ... | ... |
| Merchandise trade balance | USD bn cum. | -1.14 | -1.29 | -2.16 | -2.93 | -5.19 | -6.67" | -0.49" | -1.38" | ... | ... |
| Current account | USD bn cum. | 2.53 | -0.74 | -0.78 | -0.32 | -1.62 | x | x | x | x | x |
| Current account | % GDP, cum. | 3.0 | -3.7 | -1.8 | -0.4 | -1.5 | x | x | x | x | x |
| Gross international reserves | USD bn eop | 19.39 | 17.3 | 17.7 | 19.1 | 22.3 | 22.3 | 22.4 | 22.4 | 23.0 | 23.5 |
| Monetary Base | % yoy eop | 53.9 | 25.2 | 22.4 | 20.3 | 17.5 | 17.5 | 26.7 | 21.7 | 27.7 | 27.7 |
| Lending rate on UAH credits ** | % pa, aop | 16.4 | 15.8 | 15.5 | 14.6 | 15.1 | 15.1 | 14.2 | 13.9 | 14.0 | 14.1 |
| Exchange rate (official) | USD aop | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 | 5.05 |
| Exchange rate (official) | EUR aop | 6.00 | 6.07 | 6.34 | 6.43 | 6.51 | 6.67 | 6.57 | 6.60 | 6.68 | 6.81 |

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations

" Monthly figures are only for merchandise exports and imports (source: Derzhkomstat)

Quarterly figures are for trade in goods and services (source: NBU)

* Monthly figures do not include the regular quarterly revision of the GDP series

**Weighted average for different maturities (source: NBU)

*** Growth rate in dollar terms

| Key Economic Indicators | | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|-----------------------------|-----------|-------|-------|--------|-------|-------|-------|-------|-------|-------|
| Nominal GDP | UAH bn | 102.6 | 130.4 | 170.1 | 204.2 | 225.8 | 267.3 | 345.1 | 441.5 | 537.7 |
| Nominal GDP | USD bn | 41.9 | 31.6 | 31.3 | 38.0 | 42.4 | 50.1 | 65.0 | 86.2 | 106.5 |
| GDP growth (real) | % yoy | -1.9 | -0.2 | 5.9 | 9.2 | 5.2 | 9.6 | 12.1 | 2.7 | 7.1 |
| Industrial production | % yoy | -1.0 | 4.0 | 13.2 | 14.2 | 7.0 | 15.8 | 12.5 | 3.1 | 6.2 |
| Agricultural production | % yoy | -9.6 | -6.9 | 9.8 | 10.2 | 1.2 | -11.0 | 19.7 | -0.1 | 0.4 |
| CPI | % yoy aop | 10.6 | 22.7 | 28.2 | 12.0 | 0.8 | 5.2 | 9.0 | 13.5 | 9.1 |
| CPI | % yoy eop | 20.0 | 19.2 | 25.8 | 6.1 | -0.6 | 8.2 | 12.3 | 10.3 | 11.6 |
| PPI | % yoy aop | 13.2 | 31.5 | 20.9 | 8.6 | 3.1 | 7.6 | 20.5 | 16.7 | 9.6 |
| PPI | % yoy eop | 35.4 | 15.7 | 20.8 | 0.9 | 5.7 | 11.1 | 24.1 | 9.5 | 14.1 |
| Exports (gs, USD) | % yoy | -13.4 | -7.9 | 17.9 | 9.5 | 10.7 | 24.0 | 42.6 | 7.5 | 13.2 |
| Imports (gs, USD) | % yoy | -14.0 | -19.1 | 18.9 | 14.1 | 4.9 | 28.7 | 31.3 | 20.4 | 22.0 |
| Current account | USD bn | -1.3 | 0.9 ° | 1.2 °° | 1.4 | 3.1 | 2.9 | 6.9 | 2.5 | -1.6 |
| Current account | % GDP | -3.1 | 2.9 ° | 3.8 °° | 3.7 | 7.6 | 5.9 | 10.6 | 2.9 | -1.5 |
| FDI (net) | USD bn | 0.7 | 0.5 | 0.6 | 0.8 | 0.7 | 1.4 | 1.7 | 6.5 | 5.3 |
| International reserves | USD bn | 0.79 | 1.09 | 1.48 | 3.09 | 4.42 | 6.94 | 9.52 | 19.39 | 22.26 |
| Fiscal balance''' | % GDP | -2.7 | -2.1 | -0.7 | -1.9 | 0.8 | -0.2 | -3.0 | -1.9 | -0.9 |
| Total state debt | % GDP eop | 49.4 | 61.0 | 45.3 | 36.5 | 33.5 | 29.0 | 24.7 | 17.7 | 15.0 |
| External state debt (total) | % GDP eop | 38.4 | 49.9 | 33.0 | 26.3 | 24.1 | 21.4 | 18.6 | 13.4 | 11.9 |
| Monetary base | % yoy eop | 21.9 | 39.3 | 39.9 | 37.4 | 33.6 | 30.1 | 34.1 | 53.9 | 17.5 |
| Exchange rate | USD aop | 2.45 | 4.13 | 5.44 | 5.37 | 5.33 | 5.33 | 5.31 | 5.12 | 5.05 |
| Exchange rate | USD eop | 3.43 | 5.07 | 5.44 | 5.30 | 5.33 | 5.33 | 5.31 | 5.05 | 5.05 |
| Exchange rate | EUR aop | 2.77 | 4.39 | 5.03 | 4.81 | 5.03 | 6.02 | 6.62 | 6.40 | 6.32 |
| Exchange rate | EUR eop | 4.02 | 5.20 | 5.10 | 4.67 | 5.53 | 6.66 | 7.22 | 5.97 | 6.65 |

SOURCES: Derzhkomstat, NBU, IFS, Ministry of Finance, own calculations

''' "Minus" denotes a consolidated fiscal deficit

° The value of goods transferred to Russia according to the inter-governmental agreement reached in May 1997 on the Black Sea Fleet division totaling USD 726 m is not included

°° The value of the aircraft complexes transferred to Russia as repayment of a gas debts according to the inter-governmental agreement reached in October 1999 totaling USD 274 m is not included.

Notes:

| | | | |
|-------------|---------------------------|-------------|-----------------------|
| avg | average | ytd | year-to-date |
| cum. | cumulative | p.a. | per annum |
| mom | month on month change | eop | end of the period |
| qoq | quarter on quarter change | aop | average of the period |
| yoy | year on year change | gs | goods and services |